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OFFICE OF REPORTS AND ESTIMATES, CIA
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WEEK OF 28 SEPTEMBER - 5 OCTOBER 1948

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SECTION I. SUMMARY OF FAR EAST TRENDS AND DEVELOPMENTS

The Kremlin may be prepared to forestall UNGA recognition of the South Korean regime by proposing a "federation" of the two competing "National" governments (page 5). President Rhee has undertaken drastic counter-measures against forces opposing his government (page 6).

Serious Japanese trade difficulties are being caused by US interest (page 5). A climax is approaching in Japanese legislative efforts to delimit trade union rights in the civil service (SECTION III, page 13).

In China the military situation of the National Government has become exceedingly critical as the result of recent defeats (page 7). The Chinese Communists are emphasizing urban administration as part of their drive to take over large cities (page 7). The long-standing deadlock in Sinkiang between Chinese officials and pro-Soviet dissidents may soon be resolved through Sino-Soviet negotiations (page 7). Loss of the Kailan coal mines to the Communists would sharply curtail Nationalist China's dwindling industrial capacity (page 8).

In Siam Premier Phibul is demonstrating his ability to strengthen his position (page 10).

In Indochina the French appear to be preparing for another fall military offensive (page 10). Meanwhile in Paris Ambassador Caffery has reiterated the US position regarding specific ECA aid for Indochina (page 10).

NOTE: In succeeding sections of this Weekly, the following marginal notations are used:

- (1) Double asterisk (**) --placed at beginning and end of information based solely on "S/S distribution" series.
- (2) Single asterisk (*) --to flag item containing "S/S distribution" series.
- (3) "A", "B", or "C" --importance, in B/FE's opinion, of the item, with "A" representing the most important ones.

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SUMMARY (continued)

The Republic of Indonesia appears to have been successful in its military drive against Communists (page 11). The acceptance of the US plan by both the Dutch and Indonesians paves the way for resumption of GOC negotiations.

In Burma tension between Burmans and Karens is increasing (page 12).

An adverse reaction is expected in the Philippines to a US decision to disband the Philippine Scouts (page 12).

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SECTION II. DEVELOPMENTS IN SPECIFIED AREAS

GENERAL

Kremlin may propose compromise on Korea at UN

"A"

The Soviet UN delegation may make a conciliatory proposal when the Korean problem is presented to the current UNGA session. It is considered probable that the Kremlin is prepared to forestall UNGA recognition of the South Korean regime an ostensible concession in the form of a proposal for the "federation" of the two competing Korean "national" governments. The Kremlin doubtless has had no illusions that its elaborate efforts to match, step-by-step, the development of a new government in the south could succeed in securing UN recognition for its puppet regime in the north. It is more likely that these Soviet moves were so timed as to assure a good bargaining position in the forthcoming UNGA discussions of the Korean problem. A Soviet "federation" proposal would be difficult to ignore and would appear sufficiently conciliatory to incline many member nations toward delaying a final UNGA decision on another delicate situation in which it cannot effectively intervene. Should this point of view prevail, the Kremlin would have succeeded in forcing the UN to accord equal recognition to a government created in defiance of its resolutions and to one created under its auspices. This would have a severely damaging effect on the domestic prestige of the infant "Republic of Korea" and would leave the Soviet position unimpaired since there would be almost limitless opportunities for Soviet obstructionist tactics in any subsequent negotiations on the principles and procedures of "federation."

China's relations with other Far East countries

"B"

Greater Chinese interest in promoting cordial relations with Far Eastern countries and in closer alignment with the US vis-a-vis the USSR is indicated in recent statements by two National Government leaders, Foreign Minister Wang Shih-chieh and former Premier Chang Chung. The Foreign Minister at the UNGA in Paris stressed the importance to the Far East of a free and united Korea, and praised the US and the Philippines for granting de facto recognition to the southern Korean regime. He warned outside countries not to interfere with self-determination of the peoples of Asia, at the same time pointing out Asia's under-representation in the Security and Economic and Social Councils. Chang Chun, in a public statement on his return from Japan, approved SCAF's policy in Japan and assured the Chinese that Japan was no longer a military or economic threat to China. He urged the creation of an Asiatic economic bloc to include Japan and the early convocation of the Japanese peace conference. Though speaking in no official capacity, Chang has been considered as acting as Chiang Kai-shek's alter ego.

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GENERAL (continued)

and his recommendations regarding Japan represent a significant contrast to the vehement anti-Japanese feeling so frequently manifest in China. However, barring greatly increased immediate US aid, continuing deterioration in Nationalist China increases the vulnerability of the National Government to Soviet overtures to mediate the civil war and tends to neutralize any positive and independent efforts China may make in foreign relations.

New Siamese policy vis-a-vis French Indochina implemented

"B"

The recent visit of a Siamese military and friendship mission to Saigon has apparently resulted in a new Siamese policy of cooperation with France vis-a-vis Indochina. Although support for Indochinese "free" movements in Siam was withdrawn after the assumption of power by the Phibul regime, little was done to inhibit the activities of these refugee groups. Since the return of the mission, however, the Siamese police have been ordered to deny the right of re-entry to Indochinese refugees who leave Siam and attempt to return. Moreover, the Indochinese refugees are checked at several different places after crossing into Siam and now are expressly prohibited from holding demonstrations or possessing arms. Since determining who are new and returned refugees is difficult, the implementation of these new orders may result in the exclusion of all new refugees from Indochina. In addition, Siamese police have been crossing into Lao territory, apparently with French consent, and are reported to have stopped several food shipments to Laotian guerrillas across the northeast border.

The genesis for this new Siamese policy probably comes from Siam's premier, Marshal Phibul, who is reported to be expecting France to return part (Lanchang) of the areas retroceded to Indochina by Siam in 1946. In May 1948, Premier Phibul publicly announced that Siam had dropped the question of ownership of the four disputed provinces which Siam took by military action and Japanese assistance in 1941. This statement was believed to have been made in return for early French recognition of Phibul's new government. However, it would appear that Phibul has been able to effect a new agreement.

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JAPAN

Japanese trade difficulties caused by US interests are outlined. SCAP has outlined the difficulties engendered by US interests which have curtailed export sales by Japan. These include such salient factors as: the CCC cotton agreement which prohibited sales of Japanese cotton textiles in the US during a period most favorable for such sales and dollar accruals therefrom; opposition by US textile groups to sales of Japanese cotton textiles to other areas capable of paying dollars; restrictions on areas of procurement of raw cotton resulting in incurring dollar costs for textiles most of which are marketed in sterling areas; efforts by US shipbuilding interests to relate US and Japanese selling prices of different quality of construction and materials; urgent requests by the US Maritime Commission that US shipping be specified in commercial deals in spite of SCAP policy to sell FOB Japan and buy CIF Japan; vigorous protests by US textile machinery manufacturers against the pricing of textile machinery sold to India on the basis of undercutting US price levels; and opposition to the importation of Japanese processed fish into the US, including a formal resolution by a State legislature. "B"

The difficulties as to procurement of cotton and sales of cotton textiles outlined by SCAP are being overcome in large part by such actions as US banking syndicate loans, the revolving fund set up by the US Congress, the occupied Japan export-import revolving fund, and the recently concluded sterling area agreements providing for sales for sterling. On the other hand, the pressure of US private shipping and fish products interests, enhanced by lingering wartime hostility will be major obstacles which can be expected to continue for some time.

In addition, SCAP states that other influences preventing the full utilization of Japanese resources for application to Japanese economic recovery or for maximizing foreign exchange income are: the continuous contributions to the Korean economy without reimbursement; initial open account sales to China of products badly needed in Japan for which there is still outstanding an indebtedness of approximately \$7,000,000; and utilization of Japanese resources in implementation of the program of reparations removals.

Efforts are being made currently to stimulate Chinese exports of iron ore and salt so as to cut down its trade deficit with Japan. The other cost items are short-term which will be eliminated within the next couple of years.

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KOREA

President Rhee has undertaken drastic counter-measures against forces opposing his government. It is probable that no real revolutionary threat exists but that Rhee is motivated by a desire to stifle growing popular opposition. In any event, his actions will serve to make the brewing political crisis more acute and may precipitate a showdown between the opposing political forces before Korea's case is disposed of by the UN. Rhee's Minister of Home Affairs claims, by the arrest of the reputed ringleaders in Seoul, to have frustrated an alleged rightist plot to overthrow the government. Three leftist newspapers have been closed, and twenty editors and newspaper staff members of various Seoul papers have been charged with fomenting revolution by the publication of "misleading" news. *3*

Widespread opposition to Rhee's policies, evident both in the National Assembly and in the Seoul press, has been spawned by his unpopular stand in favor of an effective rice collection bill, his controversial Cabinet appointments, and general apprehension over his broad constitutional powers.

Rhee's police action against rightist and moderate political opponents, suppression of the critical Seoul press, and veto of the Assembly's rice collection bill will only serve to unite the opposition groups in the Assembly who have been planning an anti-Rhee coalition to effect constitutional changes reducing the President's power.

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CHINA

The National Government's military position is "exceedingly critical" "A" as a result of severe military reverses suffered during the past week. Successive Communist attacks cutting through the Chinhien-Mulutao area of the Jehol-Liaoning corridor against the troops of FU Tso-yi and FAN Han-chich have isolated Nationalist units, thereby setting the stage for their annihilation. Concurrently Communists are attacking the Kwelsui-Tatung sector forcing FU Tso-yi to move his troops west to protect the vital Peiping-Suiyuan Railroad thereby weakening the Peiping-Tientsin sector. Following the fall of Tsinan nine Red columns were released for further operations. Four of these columns are now reported moving south, possibly toward Hsachou. This force constitutes for the Communists a large strategic reserve which the Government is totally lacking in any sector. In Manchuria the Generalissimo ordered the Nationalist commander WEI Li-huang to air-lift one army from Mukden to Chinhien but the air-lift was not completed due to Communist capture of the air-strip. WEI has also been ordered to move 15 of the remaining 20 divisions defending Mukden southwest to assist FAN Han-chich in his attempt to hold the corridor. WEI Li-huang has so far failed to carry out the Generalissimo's orders. Throughout all operational areas the Communists retain the initiative and capability of concentrating decisive strength in any area without sacrificing any of their present positions. Some US military observers believe cessation of large-scale Nationalist military resistance may only be a "matter of time."

The Chinese Communists are now emphasizing urban administration as "B" part of their drive to capture and hold cities. They are intensifying an effort which has been developing for several months and which contrasts with their former program aimed at rural administration. In capturing cities they hope to assume control of the Nationalist urban political and economic machinery unimpaired by offering protection to practically all elements of the population, including foreigners, providing they cooperate with the conquerors. Their own political cadres are being trained to go in with the army and keep the municipal organs operating effectively. In connection with their policy toward cities the Communists are also stressing industrial development and are appealing to private capital and skilled technicians whose assistance they undoubtedly need. Their emphasis on cities is an indication of the progress the Communists are making in carrying out a coordinated military, economic and political program.

A Sino-Soviet agreement concerning Sinkiang may be forthcoming. "A" There are signs that the long-standing deadlock between Chinese officials and pro-Soviet Ili dissidents in Sinkiang may soon be resolved by an *

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understanding between the USSR and representatives of Gen. CHANG Chih-chung, top Chinese official for Northwest China. The replacement of Sinkiang Garrison Commander Gen. SUNG Hsi-lien, strongly anti-Soviet and an advocate of rule by force, by Gen. TAO Shih-yueh, a conciliatory "politician-general" like CHANG Chih-chung, suggests that the latter may be laying the groundwork for an agreement with the USSR. Recent reports of a relaxation of the Soviet grip on the Ili area of Sinkiang suggest that arrangements for Soviet mediation in Sinkiang may be underway. Renegotiation of the Sino-Soviet Aviation Agreement may well be included in such an arrangement. LIU Tse-yung, Foreign Office Commissioner for Sinkiang who is said to be on excellent terms with the Russians, went to Alma Ata five weeks ago with authority to negotiate a new airline ** agreement. He may also be discussing the overall Sinkiang problem with ** the USSR.

Although there is precedent for a purely local Sino-Soviet understanding in Sinkiang, it is possible that Soviet mediation there at this time could: 1) broaden into discussions of all outstanding Sino-Soviet issues, including the question of coalition with the Chinese Communists, should the National Government accept a formal offer of Soviet mediation; or could 2) be one of a series of local agreements, should Nationalist China drift into regional warlordism.

Shanghai's coal supply has reached a dangerous low. No coal shipments from the important Kailan mines have been made since 13 September with the result that Shanghai's stockpile is already well below the emergency level of 50,000 tons. Furthermore, no coal is expected to be shipped from the Kailan mines for three or four more weeks as the Communists continue to block the railroad to the port of Chinhuangtao. The possibility of Communist capture of the mines is increased by the ** diversion elsewhere of Nationalist troops from eastern Hopei and, in any case, the Nationalists are incapable of preventing Communist interruption of the railroad. Since Nationalist industries and power plants depend ** on Kailan coal for 70% of their requirements, the loss of the mines will sharply curtail China's dwindling industrial capacity. "B" *

Shanghai economic control areas expanded. Gen. CHIANG Ching-kuo's jurisdiction has been extended to cover the provinces of Chekiang, "C" Anhwei and Kiangsu (including Nanking), an area comprising, in terms of the Chinese economy, the richest section of the country in agricultural and industrial production. This extension would permit supervision of the source of Shanghai's food and raw material supplies which recently have failed to reach the city in sufficient volume. Also the flight of local hoardings to surrounding areas will now come under CHIANG's purview. In spite of this enlarged sphere, price stabilization is expected to

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fail in view of the small segment of the total economy in which control measures are even remotely possible.

Currency/Prices. No significant economic developments attributable to the fall of Tsinan to the Communists have yet been observed, however, repercussions are expected when the loss of this strategic city is fully realized. The Shanghai foreign exchange black market is still confined to undercover dealings; meanwhile, the future stability of the gold yuan rests almost entirely on the Government's ability to hold the line militarily. Shanghai prices changed little during the past week due to police measures which have resulted in compressing an already tight commodity market. The price freeze has retarded the flow of consumer goods and raw materials to the metropolitan area while inflationary idle funds are beginning to accumulate. Farmers are generally unwilling to sell their goods at the low ceiling prices. However, prices in uncontrolled cities continue to rise. "G"

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SIAM

Phibul consolidates position. It is believed that Premier Phibul, by "B" implementing a program of cooperation with France, is endeavoring to strengthen his political position by appealing to Siamese irredentism. (See General item). If Phibul successfully engineers the return to Siam of the Lanchang area and is able to utilize effectively the recent weakening of his opposition in Parliament, he can be considered firmly entrenched. Furthermore, the efficient suppression of an attempted coup d'etat on 1 October is evidence of Phibul's ability to further consolidate his position.

INDOCHINA

French may launch fall offensive. Despite less favorable circumstances "A" the French appear to be preparing for another military operation in Indochina similar to the ill-fated offensive of last October. Although replacements and reinforcements from France numbering in the "low thousands" are scheduled to arrive during the month, serious equipment deterioration and the low morale of French military personnel argue against any large scale or successful operation. It is expected that the Viet Minh forces in the Tonkin area will be the main objective. The French consider the Viet Minh lack of medical supplies and ammunition as vulnerable weaknesses. However, the French recently have had serious supply and communication difficulties of their own, including the inability to supply a French garrison only ninety miles north of Hanoi, which has been at half strength because of casualties and tropical illnesses. Lack of success in this expected operation may result in a French decision to withdraw their forces to Cochinchina and Cambodia.

US position on ECA aid for Indochina reiterated. In response to repeated French requests for direct and specific ECA aid for Indochina, US Ambassador Caffery in Paris has recently reiterated the US position to French Foreign Office officials. The US considers that substantial progress in the direction of encouraging nationalists in Vietnam to change their allegiance from the Viet Minh to a non-Communist side could be made through Assembly legislation or some other action which will permit a change in the status of Cochinchina and by negotiation of supplementary agreements envisaged in the 5 June Franco-Vietnamese accord. The Ambassador again indicated the willingness of the US to approve publicly such steps after which assistance would be given to the French Government through ECA aid. In view of the unsettled domestic political situation in France, however, it is doubtful that any positive action will be taken in the near future which could solve the Indochina problem.

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INDONESIA

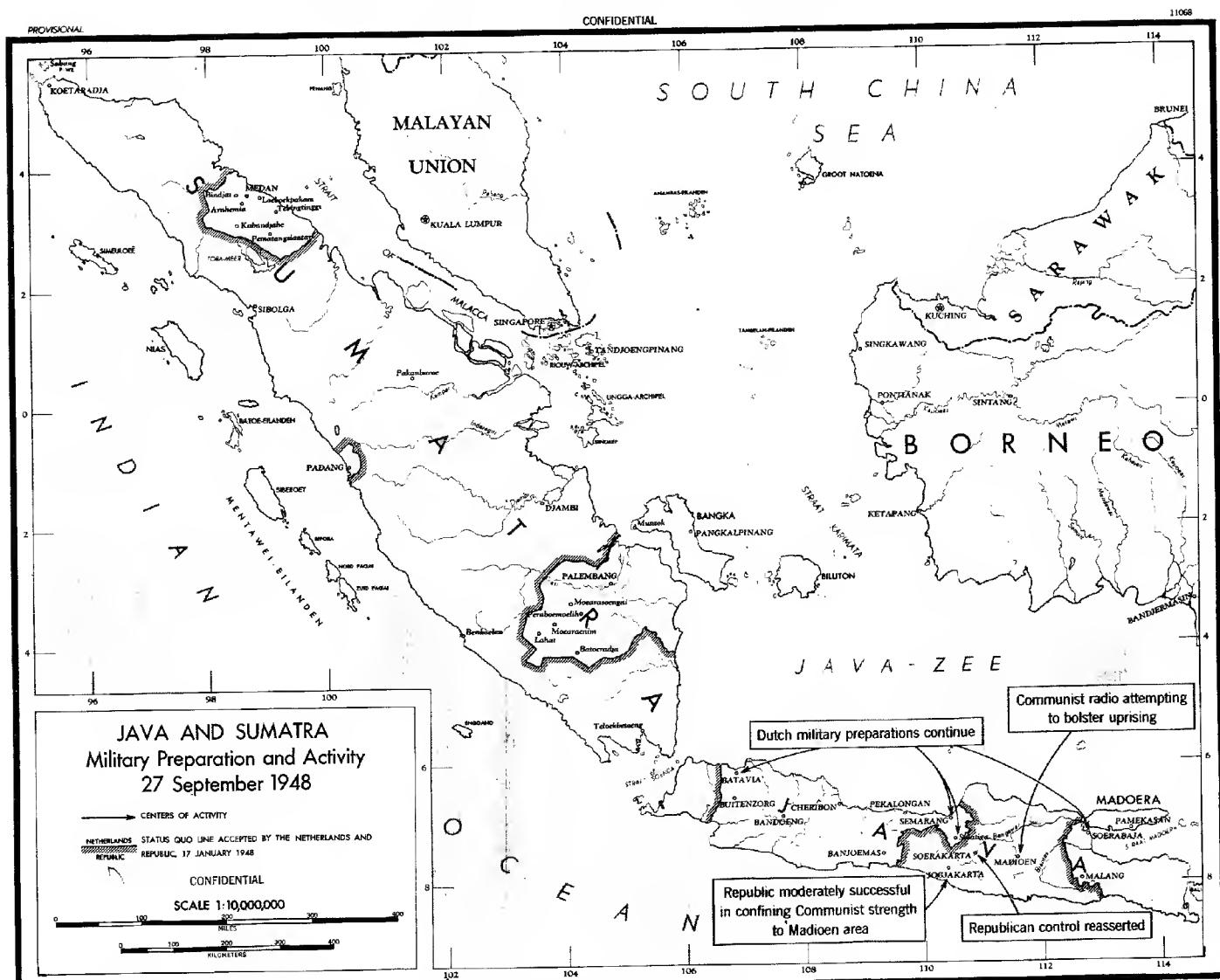
Indonesian Republic successful in military drive against Communists. "B"
By 27 September it appeared that the Republic had been only moderately successful in coping with the Communist insurrection (see map). However, on 30 September troops of the Republican Army (TNI) retook Madicoen where 12 days before Communists led by Soviet-trained Moeso had announced the formation of a Communist government. Following the fall of Madicoen and several smaller cities in its vicinity the main Communist forces, consisting of about three battalions, are reported to have withdrawn to the mountains southeast of Madicoen. Republican officials estimate that remnants of Communist forces will be eliminated in about two months. It is expected, however, that extremists in the Republic will continue to take advantage of the serious internal economic difficulties increasingly aggravated by the Netherlands economic blockade and the lack of communications between Republican areas.

Acceptance of US plan paves way for resumption of negotiations. Accept- "A"
ance of the US Delegation's draft agreement on Indonesia by both the Netherlands and Republican Governments paves the way for resumption of negotiations under the UN Good Offices Committee (GOC). The Republic qualified its acceptance by stating that it reserved the right to take any position in the course of discussions on the US paper which it may find desirable. The Republic also maintained that the actual resumption of negotiations depends upon the settlement of three problems: (1) return of a Republican shrine in Batavia which the Dutch confiscated in August; (2) immunity of members and personnel of the Republican Delegation when in Netherlands-controlled territory; (3) reconsideration of an order by Netherlands Indies authorities that Republican officials and their families leave Batavia. The Netherlands Government has announced that it will accept the US proposals with the same reservations attached by the Republic to its acceptance. With regard to the above three conditions stipulated by the Republic, the Netherlands has intimated that it will adopt as conciliatory an attitude as possible in return for which the Netherlands expects the Republic to assure full implementation of the January 1948 truce agreement, including suppression of infiltration, sabotage, guerrilla activities, and opium smuggling.

It is believed that each side has the ability to make the relatively simple concessions required by the other in order to resume the negotiations. The major test will come in the actual negotiations where both the Republicans and the Dutch will be forced, if a compromise settlement is to be achieved under the GOC, to alter substantially the position taken by them for the past three years.

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BURMA

Burman-Karen tension increases. Increasing tension between Karens and Burmans has developed as a result of the recent defection of Karen military police elements in eastern Burma. Karen leaders and elders, with a view towards a peaceful and democratic settlement of the Karen autonomy question, are reported attempting to restrain the more radical Karen elements but so far have not been entirely successful. Although no clashes between Karens and Government forces have yet been reported, Smith-Dun, the Karen commander of the Burmese Army, is reported to be less optimistic over the situation. A delicate political balance obtains at present in which Premier Thakin Nu cannot do without Smith-Dun and the Karens. This prevents Thakin Nu from making any compromise with the Communists to whom the Karens are unalterably opposed. Should a Burman-Karen showdown occur, it is likely that Smith-Dun and other Karens in the army would resign and side with their own people. "B"

PHILIPPINES

Adverse reaction expected to US decision on Philippine Scouts. Considerable adverse reaction can be expected in the Philippines when a US decision affecting the Philippine Scouts becomes public knowledge. Embassy Manila has recently been instructed to deliver an aide memoire to President Quirino stating that the US has decided, as a general rule, not to re-enlist alien members of the Philippine Scouts. (The Philippine Scouts are a unit of the US Army formed early in the century and consisting of Filipino enlisted men largely under US officers.) This decision was based on traditional US policy not to utilize alien troops and became necessary because of the independent status of the Philippines. However, Scouts who enlisted in the prewar period and those who are American citizens will be given an opportunity to enlist in the Regular US Army. Disbandment of the Scouts on a phased basis is expected to be completed by 30 September 1949. "B"

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SECTION III. DIGEST OF IMPORTANT STUDIES AND ESTIMATES

GOVERNMENT WORKER ISSUE APPROACHING CLIMAX

Japanese government efforts to amend existing civil service legislation to implement the limitation of trade union rights for government employees suggested in General MacArthur's letter to Premier Ashida of 22 July are approaching a climax. Government-CHQ, SCAP negotiations have elicited general cabinet understanding on the terms of the measure and an agreement for the convocation of the extraordinary Diet session to consider the proposed legislation commencing 11 October. Passage of the bill in its present form is assured unless (1) modifications are forced on SCAP and the Japanese Government by the US Government under pressure from other members of the Far Eastern Commission or (2) Diet deliberations produce changes acceptable to SCAP.

SCAP's interest in the passage of this legislation stems from his responsibility for the maintenance of peace and order in Japan and from his desire to prevent stoppages in critical government services, particularly those of transportation and communication, which have in the past and may in the future threaten Japan's economic recovery. Strike bans have twice in the past been used to avert specific dangers. In sponsoring legislative rather than executive action SCAP concedes the chronic character of the threat of labor unrest in Japan which can be expected to continue until the conditions of economic stability are assured.

In forwarding the revised National Public Service Law draft which has his approval, the Supreme Commander notes that following the Soviet attack on the principles embodied in his letter of July 22, ideological conflict has increased in Japan with manifest encouragement to local Communists. General MacArthur believes that any public show of lack of support by the American Government would gravely weaken the US position in Japan and throughout the Far East and render his position extremely difficult if not untenable.

In view of its promise to scrutinize Japanese legislation on this subject for conformance with occupation objectives, the US Government is confronted with issue of accepting the draft and defending it against attack in the FEC by use of the veto if necessary or of stipulating that changes be made with the risk of loss of face by SCAP.

The draft bill's terms with regard to the trade union rights of government employees represent an easing of the restrictions which have obtained under the cabinet order. In contrast with the interim ordinances which blanketed all government employees with a prohibition of the right to strike and to bargain collectively, the draft bill recognizes the

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distinction, suggested in General MacArthur's letter, between employment in government agencies (civil service) and in government-operated enterprises. In pursuance of this distinction the draft revision provides for the establishment of public corporations for the government-operated railways and for the tobacco and other monopolies. The bill would permit employees of these corporations to bargain collectively, and although maintaining the ban on the right to strike would provide arbitration machinery to hear disputes not settled by existing conciliation and mediation facilities.

Nevertheless the draft revisions in the form approved by General MacArthur comprise a relatively conservative resolution of the points of issue in the original SCAP letter and the Cabinet order raised by the Soviet and British Commonwealth representatives in Tokyo and Washington and by opponents of the restriction in the Japanese Government. This draft is not likely to satisfy the demands of the Soviet Union which has demanded an FEC directive recalling SCAP's letter. As long as the pre-eminent position of the US in carrying out occupation aims in Japan is recognized Soviet disapproval need not compel revision of specific policy measures such as this. It remains to be seen, however, whether British Commonwealth representatives will consider that the bill's provisions provide adequate guarantees of trade union rights. UK, Australia, and New Zealand have no objection to the general denial of the right to strike on the part of civil servants. The draft provisions, however, fail to accord the following rights, to which the British Commonwealth countries have become accustomed by years of experience: the right of collective bargaining coupled with the right of appeal to arbitration for all regular civil servants and the exception of the employees of government-operated enterprises from no-strike legislation. Provision in the bill of arbitral procedure of the settlement of disputes arising with employees of this latter category, however, may be considered by the UK, at least, as an acceptable substitute in recognition of a peculiarity (i.e. immaturity) in the trade union situation in Japan.

Whether the Japanese Socialist Party will accept the present draft depends on left-wing calculations of the political benefit of opposition status. The limitations embodied in the interim ordinance were a serious blow to their trade union supporters and greatly embarrassed the Socialists. Nevertheless, the Socialists have concentrated their efforts towards affecting modifications through democratic processes before the passage of permanent legislation. During the period of drafting Socialist ministers obtained Government agreement on the inclusion of principles similar to those raised in British Commonwealth representations. These principles were not included in the drafts emanating from final conferences between the Japanese Government and SCAP.

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It is reported that only consideration of the penal provisions is delaying the full Cabinet agreement expected before the measure is placed before the Diet. Socialist criticism of those provisions providing for criminal rather than administrative punishment for violations related to the present law partakes in part the nature of a delaying action. Socialist ministers in order avoid the onus of precipitating the fall of the cabinet by opposing the government's endorsement of the SCAP-approved draft National Public Service Law are awaiting (1) the outcome of the Showa Denko scandal which is threatening the life of the Cabinet; and (2) the development of US and FEC reaction to the draft. On the other hand, the Socialists because they (1) fear the levying of further restrictions on labor by conservative forces should the Socialists withdraw from the coalition; and (2) desire continued administrative power, are inclined to compromise. On the other hand, they stand to gain additional prestige in Japan if they succeed through international pressure on SCAP in preserving for government employees the widest possible sphere of trade union rights.

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